



REBECCA OTTO  
STATE AUDITOR

## STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500  
525 PARK STREET  
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)  
(651) 296-4755 (Fax)  
[state.auditor@state.mn.us](mailto:state.auditor@state.mn.us) (E-mail)  
1-800-627-3529 (Relay Service)

August 5, 2009

The Honorable Tom Larson  
Mayor, City of Menahga  
726 5<sup>th</sup> Lane Northwest  
Menahga, Minnesota 56464

Dear Mayor Larson:

The Office of the State Auditor (“OSA”) received concerns regarding the amount of money deposited by the City of Menahga (“City”) into a fire equipment sinking fund (“sinking fund”) between 1997 and 2007. The City of Menahga, Blueberry Township, Huntersville Township, and Shell River Township were all contributing to the sinking fund that was to be used for future fire truck purchases.<sup>1</sup>

In order to review the concerns, we requested and reviewed various City documents. The City, however, failed to provide us with all of the documents we requested. Therefore, we also obtained and reviewed documents from the above-identified towns.

Our review covered the time period of January 1, 1997, through November 30, 2008. Based upon our review, we determined that, as of December 31, 2007, a total of \$42,694.50 should have been contributed to the sinking fund based upon contracts between the City and the towns. When the corresponding estimated interest is added, the total amount becomes \$48,794.50. Instead, as of December 31, 2007, the sinking fund contained only \$34,355.76 in deposits and interest. As a result, the City owed the sinking fund \$14,438.74. In addition, as discussed in more detail in this letter, we question whether \$5,497.00 was properly deposited into the sinking fund in August 2007. If the \$5,497.00 should not have been deposited into the sinking fund, the City owed the sinking fund \$19,935.74 as of December 31, 2007.

In 2008, the City deposited \$20,450 in the sinking fund from fire call fees the City had collected between 2003 and 2007. It is unclear whether the City Council intended to use the fire call fees to make the sinking fund whole for the City and town contractual obligations. Assuming no legal restrictions on the City’s use of the fire call fees collected between 2003 through 2007, and we are aware of none, the City could use the fire call

---

<sup>1</sup> A sinking fund is generally used to accumulate funds collected over time to retire debt payments.

fees to make the sinking fund whole. If that is the City Council's decision, as of November 30, 2008, the City did not owe the sinking fund anything additional.<sup>2</sup>

The City Council could, however, decide that it wanted the fire call fees collected during 2003 through 2007 to be deposited in the sinking fund in addition to the contractual obligations. If that is the case, it appears the sinking fund was short by \$22,819.70 as of November 30, 2008.

In this letter we will describe the types of funds deposited into the sinking fund, including:

- Contractual sinking fund obligations;
- Fire call fees; and
- Truck purchase payments.

We will then provide a year-by-year analysis of the sinking fund. We will also provide recommendations to increase the transparency of the sinking fund in the future. Finally, we will provide additional recommendations to the City that are unrelated to the sinking fund.

## **I. REVIEW OF SINKING FUND**

The City of Menahga has a municipal fire department. Over the years, the City entered into written contracts with the Towns of Blueberry, Huntersville, and Shell River to provide fire protection services to the towns.<sup>3</sup> The contracts created a Fire Contract Committee ("Committee") to which "all matters regarding interpretation and implementation" of the contracts would be referred.<sup>4</sup> Under the contracts, the Committee would meet at least annually to review the town payments for the next year and "any other business" relating to the contracts. The Committee consisted of two City Council members, the City Clerk/Treasurer/Administrator ("City Administrator"), the Fire Chief, and a township officer from each town served by the Fire Department.<sup>5</sup>

---

<sup>2</sup> The OSA did not review whether fire truck payments or 2008 fire call fees were timely deposited in the sinking fund in 2008.

<sup>3</sup> See, e.g., Agreement for Fire Protection Service dated April 1, 2007, between the City and the Town of Huntersville. The agreements for 2001 and 2003 through 2007 appear to be identical. We were provided with KOPP formula worksheets, but not written agreements, for 1999, 2000, or 2002. The 1994 through 1998 agreements are slightly different, but still refer to the KOPP formula. The 2008 agreements provide a payment amount based on the percentage of tax capacity multiplied by the fire budget.

<sup>4</sup> See, e.g., 2007 Agreements for Fire Protection Service. Under the contracts, if the Committee could not resolve a contract-related issue, the matter was to be submitted to binding arbitration.

<sup>5</sup> The former City Administrator served from 1997 through 2002, and assisted the City with year-end matters in 2003. The current City Administrator has served from 2003 to the present.

**A. Fire Service Protection Contractual Obligations to the Sinking Fund**

During a February 7, 1996, Committee meeting, the Committee agreed to recommend to the City the creation of a sinking fund. According to the Committee meeting minutes, the sinking fund would be designated for the purchase of fire trucks and was not to be used for other fire department equipment unless there was prior approval from the townships.<sup>6</sup> During a Committee meeting on February 5, 1997, the Committee agreed on an amount of \$2,500 for the sinking fund, to be split among the towns and the City.<sup>7</sup>

Under the contracts, the amount each town would pay for fire protection services, and the amount the City and the towns would contribute to the sinking fund, was calculated using a method known as the KOPP formula. Generally, the KOPP formula is a percentage of the prior year's fire department expenses, based upon each town's 5-year average of fire calls, plus a percent of the total estimated market value for the towns and the City.<sup>8</sup> Each year from 1997 through 2001, \$2,500 for the sinking fund was to be split among the towns and the City.<sup>9</sup> The amount for the sinking fund was increased to \$5,000 in the 2002 contracts, and remained at \$5,000 through 2007. KOPP formula payments for the sinking fund were discontinued in the 2008 contracts.<sup>10</sup>

Using the KOPP Formula, the total amount the City and towns should have paid to the sinking fund from 1997 through 2007 was \$42,694.50. The contractual obligations are reflected in the chart on the following page.

---

<sup>6</sup> See February 7, 1996, Committee Meeting Minutes. Since 2003, the Committee meeting minutes were generally prepared by the City Administrator.

<sup>7</sup> See February 5, 1997, Committee Meeting Minutes. The Committee agreed that the \$2,500 should be put into a certificate of deposit (CD) in order to earn more interest. As discussed later in this letter, we were unable to determine whether the City put the funds in a CD.

<sup>8</sup> It is our understanding that the formula is based upon work by the Minnesota State Colleges and Universities' Fire/EMS/Safety Center. The League of Minnesota Cities ("LMC") website contains a model contract which uses a simplified version of the formula, available at: <http://www.lmc.org/page/1/Fire.jsp>. The LMC model contract was referenced in the February 15, 2007, Committee meeting minutes.

<sup>9</sup> See 1997 through 2001 KOPP formula worksheets.

<sup>10</sup> As discussed later in this letter, the City and towns entered into separate agreements in 2008 that required fire call fees to be deposited in the sinking fund.

<b>Sinking Fund Contractual Obligations For Towns and City</b>					
Year	Menahga	Blueberry Town	Huntersville Town	Shell River Town	Total
1997	\$1,151.50	\$873.75	\$117.50	\$357.25	\$2,500.00
1998	\$1,132.50	\$951.75	\$82.50	\$333.25	\$2,500.00
1999	\$1,050.75	\$1,017.50	\$106.00	\$325.75	\$2,500.00
2000	\$1,015.25	\$1,030.50	\$112.25	\$341.75	\$2,499.75
2001	\$1,015.00	\$918.00	\$155.25	\$411.50	\$2,499.75
2002	\$1,911.50	\$1,864.50	\$446.00	\$778.00	\$5,000.00
2003	\$1,849.50	\$1,822.50	\$529.50	\$798.50	\$5,000.00
2004	\$1,926.00	\$1,772.00	\$468.00	\$834.00	\$5,000.00
2005	\$1,996.00	\$1,923.00	\$438.00	\$740.50	\$5,097.50
2006	\$1,996.00	\$1,923.00	\$438.00	\$740.50	\$5,097.50
2007	\$2,217.50	\$1,733.00	\$437.50	\$612.00	\$5,000.00
<b>Totals</b>	<b>\$17,261.50</b>	<b>\$15,829.50</b>	<b>\$3,330.50</b>	<b>\$6,273.00</b>	<b>\$42,694.50</b>

With the corresponding estimated interest of \$6,100, we believe the sinking fund balance should have been \$48,794.50 as of December 31, 2007, based upon the City and town contractual obligations.<sup>11</sup> Because these were contractual obligations that specifically referenced the sinking fund, we believe the City was required to deposit these funds in the sinking fund.

During 1997 through 2007, the towns paid the City under the contracts, although we noted that some payments were made after the date specified in the contracts. However, as discussed later in this letter, the City did not consistently deposit either the payments made by the towns or its own payments in the sinking fund.

#### **B. City Payments to the Sinking Fund for Fire Call Fees**

In addition to the sinking fund contractual payments, the City deposited fees it collected for fire calls into the sinking fund in 2008.

Based upon our review of the Committee meeting minutes, the City has charged for fire calls since at least 1996.<sup>12</sup> At some point, the City stopped charging for fire calls.<sup>13</sup> Then, on March 10, 2003, the City Council approved fire call fees for City and township

<sup>11</sup> We estimated the interest amount using the annual percentage yield rates obtained from the City's financial institution statements (\$42,694.50 + \$6,100 = \$48,794.50).

<sup>12</sup> See February 7, 1996, Committee Meeting Minutes.

<sup>13</sup> See February 16, 1999, Committee Meeting Minutes.

residents of \$300 for the first hour and \$200 for each additional hour.<sup>14</sup> The City Council meeting minutes stated: “The [fire call] money would be set aside in a sinking fund to be used for equipment and trucks with the city notifying the townships of expenditures.”<sup>15</sup> From the minutes, it is unclear whether a separate sinking fund was to be set up or whether the fire call fees were to be added to the sinking fund created for the contractual City and town sinking fund payments. According to the current City Administrator, the fire call fees were to be added to the same sinking fund as the contractual City and town sinking fund payments.

On January 14, 2008, the City Council adopted City Ordinance 31.08. The Ordinance, effective January 16, 2008, authorized the City to impose fire call fees and to certify delinquent amounts to the County Auditor for collection with property taxes.<sup>16</sup> The Ordinance provided that all collected fees “will be designated as city funds and will be deposited into a fund, to be designated by the City Council, to offset equipment purchases.”<sup>17</sup>

In May 2008, the towns accepted the responsibility for billing and collecting the fire call fees arising from calls in their towns, and the City agreed to collect the fees for all calls within the City limits.<sup>18</sup> The towns agreed to turn over the fees collected to the City in the following year. According to the 2008 Agreements, the fire call fees collected by the City and the towns were to be deposited in the 4-M Equipment Fund (the sinking fund).

We requested the City’s listing of all fire call fees billed and collected by the City from 2003 through 2007. The fire calls reported to us by the City are identified in the chart on the following page.

---

<sup>14</sup> In 2003, the Minnesota Legislature gave cities the express authority to pass an ordinance establishing fees for emergency services, including fire protection services. *See* Minn. Stat. § 415.01, subd. 2. The LMC has model ordinances on its website at: <http://www.lmc.org/page/1/Fire.jsp>.

<sup>15</sup> *See* March 10, 2003, City Council Meeting Minutes. The March 6, 2003, Annual Fire meeting minutes state that the fire calls fees were approved. The minutes also document discussions about the sinking fund “that is to be establish [sic] and the possibility of the City not spending money from it unless the contract parties are in formed [sic]. Consensus was that the City will keep them informed when spending money on equipment from the fund.”

<sup>16</sup> We were not provided with any prior City ordinances governing fire call fees.

<sup>17</sup> *See* City Ordinance 31.08, section 7. It is unclear whether the ordinance is referring to the sinking fund.

<sup>18</sup> *See, e.g.,* 2008 Fire Contract Committee Agreement For Fire Calls dated May 10, 2008, signed by the Mayor and the current City Administrator, and the Town of Blueberry Chair and Clerk. *See also* April 14, 2008, City Council Meeting Minutes (agreement for towns to bill for fire calls was approved). Under the Agreement, the towns would place uncollected fire calls on taxes for collection. We question whether the May 2008 Agreements are consistent with City Ordinance 31.08 because the Ordinance authorizes the City (not the towns) to collect fire call fees from property owners in towns to which the City provides fire protection services pursuant to a fire protection contract. We received no evidence that the Ordinance had been revised or repealed.

<b>Fire Call Fees Reported by City to OSA</b>			
Year	Amount of Fire Calls Billed	Amount of Fire Calls Collected	Difference
2003	\$4,375.00	\$2,975.00	\$1,400.00
2004	\$3,375.00	\$2,675.00	\$700.00
2005	\$5,550.00	\$4,850.00	\$700.00
2006	\$8,450.00	\$6,850.00	\$1,600.00
2007	\$5,950.00	\$3,100.00	\$2,850.00
<b>Total Reported by City</b>	<b>\$27,700.00</b>	<b>\$20,450.00</b>	<b>\$7,250.00</b>
<b>Additional Fire Call Fees Identified by OSA</b>			
2003	\$900.00	\$1,900.00	
2007		\$200.00	
2008		\$900.00	
<b>Total Fire Call Fees</b>	<b>\$28,600.00</b>	<b>\$23,450.00</b>	<b>\$5,150.00</b>

We also compared the fire call listing the City provided to us with the City’s actual receipts. Based upon that comparison, we found the City billed an additional \$900 that was not included on the City’s list, and collected an additional \$3,000 in fire call fees from 2003 through 2007 billings. As reflected in the chart above, we determined that the City actually charged \$28,600 for 2003 through 2007 fire calls, and collected \$23,450, resulting in an unpaid fire call balance of \$5,150.<sup>19</sup>

Based on the March 10, 2003, City Council meeting minutes and our review, it appears that \$23,450 should have been deposited in the sinking fund. However, we know of no legal restrictions on the use of these funds. Absent a legal restriction, a city council’s designated use of funds may be subject to change. As discussed later in this letter, the City deposited \$20,450 of fire call fees in the sinking fund in June 2008.

**C. Town Payments for the 2004 Fire Truck Purchase**

In addition to the sinking fund contractual payments and the fire call fees deposited into the sinking fund, the City, in 2008, deposited town payments for a 2004 fire truck purchase into the sinking fund.

The City purchased a fire truck in late 2004.<sup>20</sup> Although the purpose of the sinking fund was to purchase fire trucks, funds from the sinking fund were not used to purchase the

<sup>19</sup> The City did not provide us with an explanation regarding why the fees were not collected.

<sup>20</sup> The 2008 Fire Contracts refer to this purchase as the 2005 truck purchase. The purchase was approved at the July 12, 2004, City Special Council Meeting. We were provided with a copy of a Change Order for the truck dated December 16, 2004. The lease-purchase financing agreement was approved on May 9, 2005. We were also provided with a schedule of lease-purchase payments for the truck. In this letter, we refer to this purchase as the 2004 fire truck purchase.

fire truck.<sup>21</sup> Instead, the City made the down payment on the truck and the towns agreed to pay the City annual truck payments beginning in 2005, and continuing for seven years.<sup>22</sup>

The August 22, 2007, Committee meeting minutes state that the City Administrator proposed placing the truck payments into the sinking fund and using the interest collected to pay off the truck early. In a January 22, 2008, letter to Blueberry Township's attorney, the City Administrator stated that the City Council authorized the move of the towns' truck payments (\$26,475.86) to the sinking fund, although we were unable to locate the transfer authorization in the City Council meeting minutes. As discussed later in this letter, town fire truck purchase payments were deposited into the sinking fund in 2008.

#### **D. Donations Not Included in the Sinking Fund**

We noted that, at times, donations to the City were used for the purchase of fire equipment. For example, the \$60,000 down payment for the 2004 fire truck purchase came from a donation from the Menahga Lions Club and fundraising by the Fire Department.<sup>23</sup> Similarly, the February 22, 2001, Committee meeting minutes state that the "Gateway Lions Club donations had been used to purchase \$18,948 in equipment and the remainder deposited in the equipment fund for the purchase of new vehicles." Due to a lack of records, we were unable to determine how much was contributed by the Lions Club in total, how much was left over, and into which account any remaining funds were deposited. However, we found no evidence that donations were deposited in the sinking fund.

#### **E. Year-by-Year Analysis of Deposits into the Sinking Fund**

When the Committee discussed the sinking fund in 1997, the Committee agreed that the sinking fund should be maintained in a certificate of deposit (CD) to obtain higher interest. Because we were not provided with the City's general ledger reports prior to 2001, we are unable to determine if a certificate of deposit was purchased for the funds. The former City Administrator told us she recalls that the fire contract money initially collected from the towns, including the sinking fund portion, was put in the City's "general fund - cash" account, and receipted as part of the fire contract payments. The former City Administrator informed us that she later created general ledger accounts on

---

<sup>21</sup> The current City Administrator told us that she was not sure why the sinking funds were not used for the 2004 truck purchase.

<sup>22</sup> See March 11, 2004, February 23, 2005, and August 22, 2007, Committee Meeting Minutes. The down payment for the truck came from donations. See March 11, 2004, Committee Meeting Minutes and March 3, 2004, letter from Fire Chief to City and towns.

<sup>23</sup> See March 3, 2004, letter from Fire Chief to City and towns. We know of no authority for city fire departments to engage in fundraising. See OSA's Statements of Position on Fire Department and Fire Relief Association Fundraisers and Donations ([http://www.auditor.state.mn.us/other/Statements/firedeptsfirereliefassnfundraisersdonations\\_0811\\_statement.pdf](http://www.auditor.state.mn.us/other/Statements/firedeptsfirereliefassnfundraisersdonations_0811_statement.pdf)) and Fire Departments, Fire Relief Associations and Checking Accounts ([http://www.auditor.state.mn.us/other/Statements/firedeptsfirereliefassnsandacct\\_0703\\_statement.pdf](http://www.auditor.state.mn.us/other/Statements/firedeptsfirereliefassnsandacct_0703_statement.pdf)).

the City's books for the sinking fund money because the towns wanted to see it accounted for separately.

Without the City's general ledger reports prior to 2001, we were unable to confirm the sinking fund account activity prior to 2001. However, the February 16, 1999, Committee meeting minutes noted that the amount contained in the sinking fund in 1999 was \$7,500 plus interest. The \$7,500 amount matched the town and City sinking fund contractual obligations.

Similarly, the February 22, 2001, Committee meeting minutes noted the amount contained in the sinking fund was \$13,250 for 2001. We observed that in August 2001 there was a separate accounting of the sinking fund in the City's general ledger. Specifically, a journal entry was made on August 31, 2001, moving \$13,250 from "general fund – cash" to a general ledger account entitled the "Fire Department Sinking Checking" account.<sup>24</sup> In addition, we observed that a portion of those funds was moved to the City's "Fire Investments" general ledger account, and interest of \$318.13 was recorded in the City's "Fire Sinking Int. Inc." general ledger account.<sup>25</sup> By the end of 2001, the amount contained in the "Fire Department Sinking Checking", "Fire Investments", and "Fire Sinking Int. Inc." general ledger accounts totaled \$13,649.14. This amount appears consistent with the town and City sinking fund contractual contributions, plus interest.

We observed that various transactions in the City's "Fire Investments" and "Fire Department Sinking Checking" general ledger accounts were recorded in 2002. As of December 31, 2002, the "Fire Investments" general ledger account's cumulative balance was zero and the "Fire Department Sinking Checking" general ledger cumulative balance totaled \$14,021.59. As a result, it appears the town and City \$5,000 sinking fund contractual contributions for 2002 were not recorded in these accounts.

In 2003 and 2004, there was no activity in the "Fire Investments" general ledger account and only year-end interest adjustments in the "Fire Department Sinking Checking" general ledger account. The interest adjustment at year-end December 31, 2003, was \$92.19 and at year-end December 31, 2004, was \$80.99, bringing the cumulative total in the "Fire Department Sinking Checking" general ledger account to \$14,194.77, as of December 31, 2004. Once again, the town and City \$5,000 sinking fund contractual contributions for 2003 and 2004 were not recorded in these accounts.

In February 2005, a general ledger transaction stated it "closed" the "Fire Department Sinking Checking" account, and \$14,113.78 was transferred to "general fund - cash."<sup>26</sup>

---

<sup>24</sup> Although the general ledger account was named a "checking" account, the former City Administrator informed us she did not believe a separate checking account was established.

<sup>25</sup> The "Fire Sinking Int. Inc." account was later called the "Fire 4-M Interest" account.

<sup>26</sup> General journal entry GJ 11785 (2/28/2005). The amount of \$14,113.78 does not include the \$80.99 December 31, 2004, interest adjustment ( $\$14,194.77 - \$80.99 = \$14,113.78$ ). At the end of 2005, \$80.99 was the remaining balance in the "Fire Department Sinking Checking" account.

The City then established two 4M Fund accounts, a regular 4M account and a 4M Plus account.<sup>27</sup> Specifically, on March 1, 2005, the City opened a Fire Fund 4M Plus account (#01-0337-2002) with a \$22,038.78 deposit from “general fund – cash” and a regular 4M Fire Fund account with the same account number.<sup>28</sup> Deposits were not made into the regular 4M Fire Fund until August 2007. These two 4M accounts are the current sinking fund accounts and were identified on the City’s general ledger as the “Fire Dept 4M Equipment Fund.”

After the initial opening of the two 4M sinking fund accounts on March 1, 2005, there were no contributions into the accounts between April 2005 and July 2007. The only activity in the accounts that existed during this time period was interest.<sup>29</sup>

In December 2005, the City opened another 4M Plus Fund account, placing \$10,513.47 into the account and naming it the “Fire Fund City” account (#01-0337-2003).<sup>30</sup> The current City Administrator informed us that the “Fire Fund City” 4M Plus Fund did not have anything to do with the sinking fund and that the fund was for fire department and Fire Relief funds. From our review of the City’s general ledger, it appears the funds in this account consisted of DNR grant funds and Fire Relief funds.<sup>31</sup>

In August 2007, \$5,497 was transferred from the “Fire Fund City” 4M Plus account to the 4M Plus sinking fund account.<sup>32</sup> We question whether the transfer of these funds to the sinking fund account was consistent with any DNR grant or Fire Relief fund restrictions.<sup>33</sup>

---

<sup>27</sup> The 4M Fund is the Minnesota Municipal Money Market Fund which is a customized cash management and investment program for Minnesota public funds. It is sponsored and governed by the League of Minnesota Cities and is an investment alternative designed to address the daily and long term investment needs of Minnesota cities and other municipal entities. The 4M Plus account paid a higher interest rate, but required more time for the transfer of funds out of the account.

<sup>28</sup> We have not determined how the City came up with the amount of \$22,038.78 that was deposited in the account. In December 2005, the name of the 4M Plus account was changed from the “Fire Fund” account to the “Fire Fund Township” account. In May 2007, the account number was changed to 35337-102. In June 2008, the name of the account was changed to “Fire Fund Equipment.”

<sup>29</sup> This lack of activity was also reflected in the City’s general ledger accounts.

<sup>30</sup> On the general ledger, the account is titled the “Fire Dept 4-M-City” account.

<sup>31</sup> Specifically, in November 2005, a debit of \$1,800 was recorded in the “Fire Department Sinking Checking” general ledger account and described as a “Fire Dept. DNR Grant” (GJ 14039). On December 15, 2005, a debit of \$8,632.48 was recorded in the “Fire Department Sinking Checking” account and described as Fire Relief funds (CR 14267) ( $\$1,800 + \$8,632.48 = \$10,432.48$ ). On December 31, 2005, \$10,513.47 was credited in the “Fire Department Sinking Checking” account and recorded as a debit in the Fire Dept 4-M-City general ledger account. At the end of 2005, \$80.99 of interest was the remaining balance in the “Fire Department Sinking Checking” account ( $\$10,432.48 + \$80.99 = \$10,513.47$ ).

<sup>32</sup> This transaction is also reflected in the City’s general ledger.

<sup>33</sup> We asked the current City Administrator for supporting documents regarding these funds and did not receive the requested documents.

In August 2007, an additional \$3,750 was deposited into the sinking fund account from “general fund – cash.”<sup>34</sup> In a January 22, 2008, letter to Blueberry Township’s attorney, the City Administrator stated that the City Council authorized the transfer to the sinking fund of only \$3,750 of the 2005 contractual payments totaling \$5,000 because the Fire Department went over budget in 2005.<sup>35</sup> In the letter, the City Administrator stated that, at the end of 2006, the City determined the \$3,750 had not been transferred, and therefore the City Council authorized the transfer of \$3,750 for the 2005 contractual payments, and \$5,000 for the 2006 contractual payments, plus interest, to the sinking fund. We were unable to locate the transfer authorization in the City Council meeting minutes.<sup>36</sup>

In January 2008, \$26,475.86 was deposited into the sinking fund account. According to the City’s general ledger entries, the deposit consisted of money collected from the towns for the 2004 fire truck purchase.

In June 2008, after the OSA was contacted about these issues, \$35,250 was transferred to the sinking fund account from “general fund – cash.” The total consisted of \$20,450 from fire call fees collected by the City between 2003 and 2007, and \$14,815 for half of the towns’ 2008 fire truck payments, minus a \$15 wire fee.<sup>37</sup>

The chart on the following page summarizes the activity in the 4M sinking fund accounts from March 2005 through November 30, 2008.

---

<sup>34</sup> Based upon our review of the general ledger, it appears that there were four general ledger transactions that ultimately showed the \$3,750 came from “general fund - cash.” Two of the transactions on the general ledger included the Fire Investment (GJ 23805) and Fire Call Charges (AP 23492) accounts which had to be corrected by an adjusting journal entry (AD 26811) at year-ended December 31, 2007.

<sup>35</sup> Because there was a contractual obligation of \$5,000 for the sinking fund in 2005, we do not believe the City had the authority to withhold a portion of the 2005 sinking fund deposit.

<sup>36</sup> We reviewed the City Council meeting minutes for 2006 and found no reference to the authorization.

<sup>37</sup> The total is \$35,250 (\$20,450 + \$14,815 - \$15 = \$35,250). The transfer of \$20,450 of fire call fees was approved at the April 14, 2008, City Council meeting. *See* April 14, 2008, City Council Meeting Minutes.

<b>Activity in 4M Sinking Fund Accounts (Opened in March 2005)</b>			
Date/Year	Fire Fund 4M Account	Fire Fund 4M Plus Account	Comments
March 2005		\$22,038.78	Accounts opened; transfer from City general fund
Interest 2005		\$576.85	
<b>Balance 12/31/05</b>		<b>\$22,615.63</b>	
Interest 2006		\$1,089.36	
<b>Balance 12/31/06</b>		<b>\$23,704.99</b>	
August 2007	\$5,497.00		From “Fire Fund City” 4M Plus account (DNR grant & Fire Relief funds)
August 2007	(\$5,497.00)	\$5,497.00	Transfer from Fire Fund 4M to Fire Fund 4M Plus account
August 2007		\$3,750.00	From City’s general fund
Interest 2007		\$1,403.77	
<b>Balance 12/31/07</b>		<b>\$34,355.76</b>	
January 2008		\$26,475.86	Town fire truck payments
June 2008	\$35,250.60		From City’s general fund: \$20,450 in fire call fees; \$14,815 town fire truck payments (minus \$15 wire fee)
August 2008	(\$35,347.73)	\$35,347.73	Transfer from Fire Fund 4M to Fire Fund 4M Plus account
Interest thru 11/2008	\$105.86	\$1,610.18	
<b>Balance 11/30/08</b>	<b>\$8.73</b>	<b>\$97,789.53</b>	

## II. DISCUSSION AND RECOMMENDATIONS

There appears to have been confusion over what funds should have been deposited in the sinking fund. Ideally, the fund would have consisted of the City and town contractual obligations, and those funds would have been deposited in the fund on a timely basis. Unfortunately, this did not happen.

The sinking fund contractual obligations for the towns and City between 1997 and 2007 totaled \$42,694.50.<sup>38</sup> With estimated interest of \$6,100, the total amount from the contractual obligations that should have been in the sinking fund as of December 31, 2007, was \$48,794.50. We believe the City did not have discretion on where the sinking fund contractual obligations would be deposited. Under the contracts' KOPP formula, they needed to be deposited in the sinking fund.

We determined that the City put \$25,788.78 in the sinking fund account from the City's "general fund – cash" between 2005 and 2007.<sup>39</sup> Including interest for that time period, contributions to the sinking fund account totaled \$28,858.76 as of December 31, 2007.<sup>40</sup>

The City Council decided in 2003 that fire call fees should be deposited in the sinking fund. We know of no legal restrictions on the City's use of the fire call fees collected from the 2003 through 2007 billings. Absent a legal restriction on the City's use of these funds, the sinking fund designation for these funds made by the 2003 City Council could be reversed by a later City Council. Assuming no legal restrictions on the City's use of these funds, the current City Council retains the authority to decide into which account these funds should be deposited.

Fire call fees were not transferred to the sinking fund until 2008 when the City deposited into the sinking fund \$20,450.00 from fire call fees collected during 2003 through 2007.<sup>41</sup> It is unclear whether the City Council in 2008 intended to use the fire call fees to make the sinking fund whole for the contractual sinking fund obligations, or whether the City Council intended to supplement the contractual sinking fund obligations with the fire call fees. Because we know of no legal restrictions on these funds, the current City Council could determine that the fire call fees were used to make the sinking fund whole for the contractual obligations. In that case, as of November 30, 2008, the City did not owe the sinking fund anything additional.<sup>42</sup> See Attachment A.

---

<sup>38</sup> See page 3 of this letter.

<sup>39</sup> The amount does not include the \$5,497 transferred to the sinking fund from the City's "Fire Fund City" 4M Plus account (the DNR and Fire Relief funds).

<sup>40</sup> Once again, this amount does not include the \$5,497 transfer of funds which is included in the sinking fund balance as of December 31, 2007 on the chart found on page 11 of this report (\$28,858.76 + \$5,497.00 = \$34,355.76).

<sup>41</sup> \$28,858.76 + \$20,450.00 = \$49,308.76.

<sup>42</sup> The OSA did not review whether fire truck payments or 2008 fire call fees were timely deposited in the sinking fund in 2008.

However, the current City Council could also decide that it wanted the fire call fees collected from 2003 through 2007 fire call billings to be deposited in the sinking fund in addition to the contractual obligations. If that is the case, it appears the sinking fund was short by \$22,819.70 as of November 30, 2008. See Attachment B.

More specifically, if the City Council determines, for reasons independent from the City's contracts with the towns, that the fire call fees from the 2003 through 2007 fire call billings should have been deposited in the sinking fund in addition to the contractual sinking fund obligations, then \$73,844.50 should have been deposited in the sinking fund as of December 31, 2007. This amount includes:

- \$42,694.50 in sinking fund contract amounts charged to the towns and City between 1997 and 2007 pursuant to the KOPP formula (page 3 of this letter);
- \$20,450.00 in fire calls collected pursuant to the City's list provided to the OSA (page 5 of this letter);
- \$8,350 in estimated interest calculated on the sinking fund contract amounts and fire calls collected through December 31, 2007;<sup>43</sup>
- \$2,100 in additional fire calls amounts collected by the City between 2003 and 2007 and not recorded on the City's list provided to the OSA (page 5 of this letter); and
- \$250 in estimated interest calculated on the additional \$2,100 collected in fire calls.

If the City Council determines that the fire call fees should have been deposited in the sinking fund in addition to the contractual obligations, the sinking fund was under-funded between 2005 and 2007 by \$44,985.74 as of December 31, 2007.<sup>44</sup> Giving the City credit for interest accumulated in the account up through November 2008 of \$1,716.04 and the fire call money of \$20,450, we found that the sinking fund would be short by \$22,819.70 as of November 2008, if both contractual sinking fund obligations and City fire call fees should have been deposited in the sinking fund.<sup>45</sup> These findings are summarized in Attachment B.

The Agreements signed in 2008 direct that future fire call fees must be deposited in the sinking fund. Similarly, City Ordinance 31.08 directs that fire call fees will be deposited in a fund, to be designated by the City Council, to offset equipment purchases. As a result, the City Council is no longer free to decide into which account fire call fees collected under the 2008 Agreements and/or City Ordinance 31.08 will be deposited. Fire call fees collected under the 2008 Agreements must be deposited in the sinking fund.

---

<sup>43</sup> We estimated the interest amount using the annual percentage yield rates obtained from the City's financial institution statements.

<sup>44</sup> \$73,844.50 - \$28,858.76 = \$44,985.74.

<sup>45</sup> We determined that the City did not collect a total of \$5,150 for fire calls billed between 2003 and 2007. If this amount is also included in the amount that should have been deposited in the sinking fund, the total amount needed to fully fund the sinking fund is \$27,969.70.

Fire call fees collected under City Ordinance 31.08 must be deposited in a fund designated by the City Council to offset equipment purchases.<sup>46</sup>

#### **A. Sinking Fund Recommendations**

The sinking fund consists of payments made by both the City and the towns. Therefore, there must be strict accountability for these funds. To avoid questions and disputes, there must be transparency for all activity in the sinking fund. Deposits into the sinking fund must be made in a timely manner. To achieve these goals, we offer the following recommendations regarding the sinking fund:

- The City Council should determine whether the City used fire call fees billed and collected during 2003 through 2007 to make the sinking fund whole in 2008 for the City and town prior contractual payments, or whether the City Council intended to supplement the contractual payments with the fire call fees. If the City Council determines that both contractual sinking fund payments and City fire call fees billed and collected during 2003 through 2007 should have been deposited in the sinking fund, then the City should transfer additional funds to the sinking fund.
- The City and the towns should determine what funds will be deposited in the sinking fund in the future. Those decisions must be clearly documented.
- The role of the Committee should be clarified.<sup>47</sup> The 2008 contracts refer “[a]ll disputes regarding interpretation, implementation, or any other aspect of this contract” to the Committee for resolution.<sup>48</sup> We believe the Committee does not have the authority to determine where the City may deposit fire call fees collected by the City from 2003 through 2007 fire call billings because the use of the fees was not part of the contracts. The decision about where to deposit fire call fees collected by the City from 2003 through 2007 fire call billings belonged to and remains with the City Council.<sup>49</sup> The City Council may change its mind regarding the use of these fees because, to our knowledge, the use of the fees is not restricted by the contracts, an ordinance, or a statute.
- Once the City and the towns determine what funds should be deposited in the sinking fund, the City and the Committee need to ensure that collections received match the amounts deposited in the sinking fund account, and that deposits are made in a timely manner. To accomplish this, City staff should periodically provide the City Council and the Committee members with documentation

---

<sup>46</sup> As noted previously in this letter, it is unclear whether the ordinance is referring to the sinking fund.

<sup>47</sup> The Committee is not a joint powers board. The Fire Department was not created as part of a joint powers agreement. Instead, the Fire Department is a city fire department, and the towns are contracting with the City for services. As a result, the City maintains financial control over the Fire Department and City funds.

<sup>48</sup> As noted previously in this letter, the contracts state that the issue must be submitted to binding arbitration if the Committee is unable to resolve the issue.

<sup>49</sup> In contrast, the fire call fees collected by either the towns or the City under the 2008 Agreements contain a contractual restriction. Those fees, under the 2008 Agreement, must be deposited in the sinking fund.

- showing the transactions into and out of the sinking fund, the fund's balance, and the interest earned. Supporting documentation, such as year-end bank statements, should be made available for inspection.
- If the sinking fund is to be used for payments for the 2004 fire truck purchase, the amounts should be transferred into and out of the sinking fund account in a timely manner.<sup>50</sup> We recommend that the City not use the sinking fund for truck activity, in order to increase the transparency of these transactions.
  - When town payments are received for, or City payments are due to the sinking fund account, the payments must be timely deposited in the 4M sinking fund account and promptly recorded in the appropriate general ledger accounts.
  - The City Council should determine whether any additional action can or should be taken to collect all or a portion of the \$5,150 in fire call charges that were billed between 2003 and 2007 but not collected.
  - The City Council should determine whether the additional \$2,100 in fire call fees collected by the City from 2003 through 2007 but not included on the City's list of collected fire call fees should be transferred to the sinking fund.
  - The City Council should review City Ordinance 31.08 and the 2008 fire call fee agreements for consistency.
  - The City Council should determine whether the transfer of \$5,497 to the sinking fund from the Fire Fund City 4M Plus account in August 2007 was appropriate and in compliance with any DNR grant restrictions and any limitations on the use of the Fire Relief funds. If the transfer was not appropriate, \$5,497 should be transferred from the sinking fund back to the "Fire Fund City" 4M Plus account.
  - The City should work with its auditors to distinguish between "reserved" and "unreserved" fire-related fund balances.<sup>51</sup> Funds that have legal/contractual restrictions on their use, such as the 1997 through 2007 contractual sinking fund payments and the fire call fees collected under City Ordinance 31.08 or the 2008 Agreements, should be designated as "reserved" funds. Funds without

---

<sup>50</sup> In January and June 2008, fire truck monies were put into the sinking fund. However, as of November 2008, no funds had been withdrawn from the account. The information provided to us showed that fire truck lease-purchase payments were due on February 1, 2008, and August 1, 2008. As a result, it appears funds should have been withdrawn from the sinking fund to make the truck payments.

<sup>51</sup> When accounting for government funds, a city should distinguish between "reserved" and "unreserved" fund balances. The function of a "reserved" fund balance is to separate those funds that are legally segregated for specific future uses. The restrictions imposed on "reserved" fund balances are legal restrictions on the funds imposed by parties other than the city. This would include funds where the use of the funds is restricted due to a contract. The part of a fund balance that is not identified as "reserved" is the "unreserved" fund balance. Fund balances that are "reserved" should be reported separately from "unreserved" fund balances. The "unreserved" fund balances may be reported as "designated" fund balances. A "designated" unreserved fund balance represents the City Council's intended plans for the funds, but those plans are subject to change since they are self-imposed limitations on the use of the funds. Additional information on governmental funds is available in our Statement of Position on Fund Balances for Local Governments, found on our website at:

[http://www.auditor.state.mn.us/other/Statements/fundbalances\\_0708\\_statement.pdf](http://www.auditor.state.mn.us/other/Statements/fundbalances_0708_statement.pdf).

legal/contractual restrictions should be reported as “designated” fund balances where appropriate.<sup>52</sup>

## **B. Additional Findings and Recommendations for the City**

During our review, we identified various concerns with the City’s handling of financial matters. We are providing the City with a summary of those concerns and recommendations to resolve these issues in the future.

### **1. Document/Record Retention**

We were not provided with all the documents we requested from the City. Specifically, we were not provided with the following documents:

- General ledgers from 1997 through 2001;
- Fire contracts from 1999, 2000, and 2002; and
- Committee meeting minutes from February 7, 1996, February 24, 2000, and February 15, 2007.

According to the General Records Retention Schedule for Minnesota Cities, adopted by the City, general ledgers and meeting minutes are permanent records and cannot be destroyed. In addition, contracts are to be maintained for ten years after they are paid and audited.

We recommend that City staff and the City Council become familiar with record retention requirements. We recommend that City staff work with the towns to obtain copies of City documents the towns may possess so the City can maintain the required permanent City records.

### **2. Accepting Donations**

The City Council was not accepting donations in compliance with Minnesota law. Donations to the fire department in the past were collected and deposited into a separate fire department checking account, which has since been closed.<sup>53</sup> The City Council did not pass resolutions accepting more recent donations and did not specify in the resolutions any terms attached to the donations.

---

<sup>52</sup> The City’s 2007 and 2008 audited financial statements show reserved and unreserved fund balances. We recommend the reserved and unreserved fire-related fund balances be reflected separately on the financial statements.

<sup>53</sup> The fire department would inform the City Council that they had received a donation. Information on fire department accounts is found in our Statement of Position on Fire Departments, Fire Relief Associations and Checking Accounts, available on our website at: [http://www.auditor.state.mn.us/other/Statements/firedeptsfirereliefassnsandaccts\\_0703\\_statement.pdf](http://www.auditor.state.mn.us/other/Statements/firedeptsfirereliefassnsandaccts_0703_statement.pdf).

Minnesota law allows cities to accept donations in accordance with the terms prescribed by the donors.<sup>54</sup> However, the donations must be accepted by the city council in a resolution adopted by a two-thirds majority.<sup>55</sup> The resolution must also fully describe any terms of the donation.<sup>56</sup>

We recommend that the City Council comply with Minnesota law by accepting all donations by resolution adopted by a two-thirds majority of the City Council. The resolution should clearly describe the amount and terms of any donation.

### 3. Receipts

During our review, we noticed the following:

- Various receipts were missing from January 1, 2003 to February 9, 2003, and November 29, 2003 to April 14, 2004;
- Many receipts in 2003 were incomplete, consisting of only an adding machine tape with a name, number, amount and date; and
- The receipts did not consistently identify whether the payment was made by cash or check.<sup>57</sup>

We recommend that the City issue receipts for all payments received. The receipts should be pre-numbered and should be issued in numerical order. In addition, all receipts should indicate the type of payment as cash or check. A review of pre-numbered receipts should be done on a monthly basis to ensure that all pre-numbered receipts are accounted for. In addition, the composition of cash and checks received should be compared to the amount of cash and checks deposited. Any breaks in the pre-numbered receipt sequence, and any variances between the cash and checks collected and the cash and checks actually deposited, should be reviewed immediately.

### 4. Meeting Minutes

We recommend that the City Council meeting minutes document in detail all funding decisions, including fire department funding and fund transfer decisions. The Committee meeting minutes should also fully document any contract issues resolved by the Committee and any funding recommendations the Committee may have for the towns or the City Council. For additional guidance on meeting minutes, a Statement of Position on Meeting Minutes is available on our website at:

[http://www.auditor.state.mn.us/other/Statements/meetingMinutes\\_0710\\_statement.pdf](http://www.auditor.state.mn.us/other/Statements/meetingMinutes_0710_statement.pdf).

---

<sup>54</sup> See Minn. Stat. § 465.03.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> We also noticed that, from 1997 through 2002, one receipt was written for multiple payments received. In 2003, the City changed its process so that one receipt was issued for each payment received.

5. General Ledger

At times, the City's general ledgers lacked sufficient detail in the description column to provide a complete description of the purpose of some transactions. As a result, it was difficult to cross reference cash receipts to the manual pre-numbered receipts. For example:

- For cash receipts, the number of the pre-numbered cash receipt, the payee, and the purpose of the payment was lacking on the general ledger; and
- For journal entries and adjusting entries, a description of the purpose of the entry was sometimes lacking.

We found that the 2007 and 2008 general ledgers were much more detailed. However, we are concerned that the City's auditors proposed numerous adjustments to the general ledger that resulted in significant changes to the City's financial statements for the year ended December 31, 2007. According to the City's auditors, the adjustments were necessary to record additional receivables, deferred revenue, and payables found during the audit; to reverse prior year receivables and payables that were subsequently received and paid; and to reclassify transfers, fund balance reserves and designations.<sup>58</sup>

We want to remind City staff that detailed, accurate, and timely general ledger entries increase transparency, as well as the completeness and integrity of the City's financial records.

6. Late Payment Policy

Based upon our review of the fire contract general ledger account, there are instances when the towns did not make their fire service contract payments by the April 1 due date.<sup>59</sup> Minnesota law requires a municipality to pay vendor obligations according to the terms of the contract.<sup>60</sup> A municipality must calculate and pay interest to the vendor if the municipality has not paid the obligation according to the terms of the contract.<sup>61</sup>

We recommend that the City and towns consider adding late fees/penalties to future contracts.

---

<sup>58</sup> In the City's year-ended December 31, 2008 audit, the City's auditors again proposed numerous material audit adjustments.

<sup>59</sup> The fire service contracts generally required payment on or before the annual agreement date of April 1. In 2008, the City Council allowed the town payments to be divided into two payments. *See* April 14, 2008, City Council Meeting Minutes. It appears the contracts were not amended to reflect this change.

<sup>60</sup> *See* Minn. Stat. § 471.425, subd. 2 (2008).

<sup>61</sup> *See* Minn. Stat. § 471.425, subd. 4 (2008).

### III. CONCLUSION

The City Council should determine whether the City used fire call fees billed during 2003 through 2007 to make the sinking fund whole in 2008 for the City and town contractual payments. If the City Council determines that the fire call fees should have been deposited in the sinking fund for reasons independent from the City's contracts with the towns, the City should transfer \$22,819.70 to the sinking fund.

We have provided recommendations to increase the transparency of the sinking fund and to help prevent disputes between the City and towns in the future. If you have any questions regarding this letter, please contact me at 651-282-2388 or by email at [Kathy.Docter@state.mn.us](mailto:Kathy.Docter@state.mn.us), or Assistant Legal Counsel Nancy J. Bode at 651-297-5853 or by email at [Nancy.Bode@state.mn.us](mailto:Nancy.Bode@state.mn.us). We consider this file to be closed.

Sincerely,

*/s/ Kathy Docter*

Kathy Docter, CPA, CFE  
Legal/Special Investigations Division  
Office of the State Auditor

cc: The Honorable Dennis Koumalainen, City Council Member  
The Honorable Joel Mickelson, City Council Member  
The Honorable Maxine Norman, City Council Member  
The Honorable Kim Rasmussen, City Council Member  
The Honorable Durwin Tomperi, Blueberry Township Board Chair  
The Honorable Dorothy Kennelly, Huntersville Township Board Chair  
The Honorable Melvin Kinnunen, Shell River Township Board Chair  
Ms. Teri Osterman, City Administrator  
Eide Bailly, LLP, City Auditors

Attachments